



P.O. Box 2749
Sacramento, CA 94229-2749
Telecommunications Device for the Deaf - (916) 795-3240
(916) 795-3400

August 18, 2008

AGENDA ITEM 3

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Policy Subcommittee Report
- II. PROGRAM:** Total Fund
- III. RECOMMENDATION:**
 - a. Asset Allocation - Adoption of Policy on Supplemental Income Plans CalPERS Risk-Based and Target Retirement Date Funds
 - b. Global Equity – Revision of Global Principles of Accountable Corporate Governance
 - c. Real Estate – Revision of Policy on Equity Real Estate
 - d. Inflation-Linked Asset Class – Adoption of Infrastructure Program Component

IV. ANALYSIS:

Background

The Policy Subcommittee met on June 16, 2008. The Subcommittee reviewed new policies for the Supplemental Income Plan Asset Allocation funds and for the Infrastructure program. In addition, the Subcommittee reviewed proposed revisions to the Global Principles of Accountable Corporate Governance and the Equity Real Estate Policy.

The proposed new and revised Policies are attached. Unless otherwise noted, the revised Policies are presented as black-lined versions from the last adopted

policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Each of the recommended policies is explained below.

Adoption of Policy on Supplemental Income Plans CalPERS Risk-Based and Target Retirement Date Funds

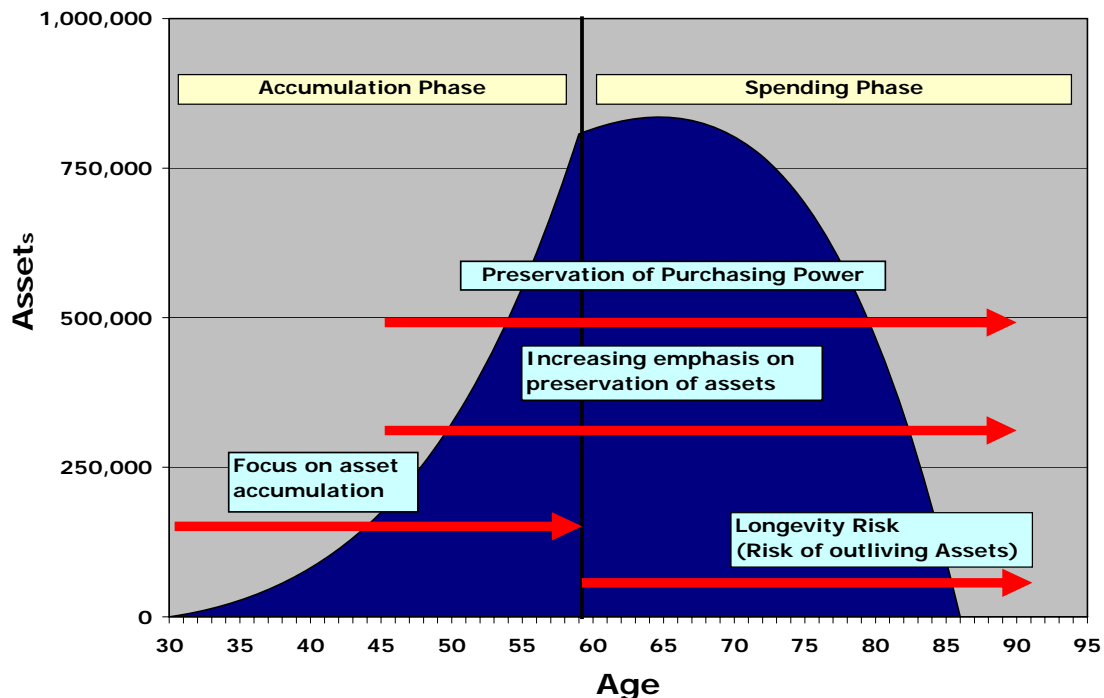
The creation of custom CalPERS Asset Allocation Funds for the Supplemental Income Plans (SIP) Program was approved by the Investment Committee in February 2008. Staff selected Callan Associates from the General Pension Consultant Spring-fed Pool, to assist with the development of these funds. In addition, the Actuarial Office contributed staff and expertise on CalPERS member demographic data. The proposed policy for this new program is included as Attachment 1.

With the implementation of this new program, participants in the CalPERS 457 and Supplemental Contributions Program will be able to choose from two series of high quality funds: Target Retirement Date Funds and Risk-Based Funds.

Fund selection focused on optimizing in-house talent and risk adjusted returns while keeping fees low. Staff made specific selections to include both internally and externally managed funds. The externally managed funds were selected from firms already managing assets for CalPERS.

The Target Retirement Date Funds offer an automatically adjusting mix of investments. These funds have asset allocation strategies that are designed to change over time. Participants benefit from favoring higher returning assets in their earlier years (Accumulation Phase) and favoring capital preserving assets in their later years (Spending Phase). This concept is illustrated in the graph below.

Lifecycle of Investing



Based on participant data, the following key factors were considered in creating the Target Retirement Date Funds: (1) retirement objective, (2) demographics, (3) other sources of retirement income, and (4) risk tolerance. The glidepath for the Target Retirement Date Funds provides for high allocations to equity securities in the early years and high allocations to fixed income securities in the later years.

Risk-Based Funds offer varying asset allocations designed to suit varying participant risk profiles. These funds have asset allocation strategies which remain constant within allowed ranges. Three Risk-Based Funds will be offered: Aggressive, Moderate and Conservative. Participants must proactively switch funds as their risk tolerance changes.

The three Risk-Based Funds are derived from the Target Retirement Date Funds glidepath. The Aggressive Risk-Based Fund is constructed to match ages 40 and under, the Moderate Risk-Based Fund is constructed to match approximately age 55, and the Conservative Risk-Based Fund is constructed to match ages 75+.

The Subcommittee recommended adoption of the Supplemental Income Plans CalPERS Risk-Based and Target Retirement Date Funds policy.

Revision of Global Principles of Accountable Corporate Governance

Recommended revisions to the Global Principles of Accountable Corporate Governance (Attachment 2) include three Global Principles amendments and the deletion of two Global Principles. Revisions include amendments to the Corporate Responsibility Section for the purpose of including reference to the 14-point Ceres Climate Change Governance Checklist. Amendments and deletions are summarized in the tables below.

Principle Amendments

Market	Identifier	Page	Topic	Principle Amendment
Domestic	B.4.8	15	Auditor Selection	Adds language on disclosure to the board's audit committee. Requires auditors to provide 3 years of history on their dealings with the company to assist the assessment of auditor independence.
Domestic	B.5.2	16	Environmental Disclosure	Adds language referencing the 14-point Ceres Climate Change Governance Checklist as directed by the Committee.
Domestic	B.6.2	17	Majority Vote Standard	Adds language to incorporate a resignation for any director that receives a withhold vote greater than 50% of the votes cast.

Principle Deletions

Market	Identifier	Page	Topic	Principle Deletion
Domestic	B.1.7	8	Corporate Insiders	Deletes this specific principle limiting the roles of corporate insiders on the board. This principle is redundant given Appendix B, Pg 50.
Domestic	B.6.4	17	Director Removal	Deletes this specific principle on director removal by shareowner action. The content of this principle has been moved to principle B.6.2.

The Subcommittee recommended approval of the revised policy.

Revision of Policy on Equity Real Estate

Real Estate's approved Strategic Plan calls for a revision to the Real Estate benchmarks. The revised benchmark represents a blend of two Real Estate indices: (1) The National Council of Real Estate Investment Fiduciaries Index ("NCREIF") Property Index ("NPI") and (2) the Financial Times Stock Exchange ("FTSE") European Public Real Estate Association ("EPRA") National Association of Real Estate Investment Trusts ("NAREIT") Global Total Return Real Estate Index (also known as the "FTSE EPRA NAREIT Global Total Return Index").

Staff recommended revising policy Section III.B. to allow for the measurement of portfolio performance to this blended benchmark.

The Subcommittee recommended approval of the revised Equity Real Estate policy (Attachment 3).

Adoption of Infrastructure Program Component of the Inflation-Linked Asset Class Policy

In December 2007, the Investment Committee approved a 5% target allocation to the new Inflation-Linked Asset Class (ILAC) consisting of commodities, inflation-linked bonds, forestland, and infrastructure investments. Also in December 2007, the Investment Policy Subcommittee approved, subject to revisions, investment policies for the overall ILAC and for three of the four ILAC components: Commodities Program, Inflation-Linked Bond Program, and Forestland Program.

To develop the Infrastructure Program component, Staff has worked extensively with Pension Consulting Alliance (PCA) and Wilshire Associates. Staff has also engaged in a process to obtain and review input from interested parties, including labor representatives, industry representatives, and others. Several drafts and opportunities to comment have been afforded to these interested parties and significant efforts have been made to address the various issues raised over the course of this dialogue.

The first reading of the Infrastructure Policy was presented to the Policy Subcommittee on April 21, 2008 and the second reading was presented to the Policy Subcommittee on June 16, 2008.

For both readings, a summary of comments received from external constituents was provided. At its June meeting, the Subcommittee requested the following

additional changes, which are shown in blackline format in the attached Infrastructure policy (Attachment 4):

1. Decrease total average leverage for the Infrastructure Program to no more than 65%. In addition, based on further review and discussion, Staff has added language requiring that any investment that has 50% or higher leverage will be brought to the Investment Committee for approval.
2. Insert additional strategic objective (section II.H.)
3. Insert clarifying language regarding domestic public sector jobs (section VI.D.2.a)

Ceres' letter of support is included as Attachment 5. PCA and Wilshire's opinion letters are included as Attachments 6 and 7 respectively.

The Subcommittee recommended adoption of the Infrastructure Program component of the Inflation-Linked Asset Class Policy, with the following revisions.

Real Estate Policy Review and Consolidation Update

Real Estate Staff presented an information item describing Real Estate's strategy for the Policy Review Project.

Staff recommended the following framework: Consolidate existing 25 policies into one overarching Real Estate Equity Policy and maintain Responsible Contractor Program, Accounting, and Appraisal and Valuation Policies as stand alone documents; remove operational and procedural language; and incorporate policy changes to reflect new Strategic Plan and current global investment conditions.

Real Estate Staff expects to present a first reading of the revised policies in October 2008, with a possible second reading in December 2008, and final Investment Committee approval by February 2009.

V. STRATEGIC PLAN:

This item supports Goal VIII: Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.

VI. RESULTS/COSTS:

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

Matt Flynn
Division Chief

Anne Stausboll
Interim Chief Investment Officer